

OFFICE OF THE
ARIZONA
STATE
TREASURER



HON. DOUG DUCEY
TREASURER

INVESTMENT
PHILOSOPHY

SAFETY
before
LIQUIDITY
before
YIELD



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Inside the Vault

The Arizona State Treasurer's Quarterly Update

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Q2 2012

Consistent & Reliable Funding for Education

The Treasurer's Office recently completed the first-ever asset allocation study for the \$3.5 billion Permanent Land Endowment Trust Fund. The most glaring take-away from the study was that the current formula, used to fund K-12 education and the 12 other beneficiaries, is complicated and has resulted in uneven and unpredictable distributions. This current formula was never market tested and in FY 2010

resulted in zero dollars going to support education.



The Board of Investment voted to introduce a new, simplified formula that will ensure reliable and consistent distributions that will protect the principal of the fund and never result in a zero dollar distribution.

"As a trustee for an endowment this large there is no reason we should have years with a zero dollar distribution," stated Treasurer Ducey. "We're now armed with critical knowledge and have a fiduciary responsibility to make certain Arizona's children and teachers have a consistent and reliable distribution every single year."

After nine years in use, the unpredictable distributions using the current formula have made it difficult for the beneficiaries to budget or plan for. Based on fund performance from 1985-2011, as well as five economic scenarios for the next 20 years, the analysis revealed that if left unchanged this formula will result in several additional years in zero dollar distributions.

Under the new, simplified formula annual distributions would be based off 2.5% of the previous 5-year market value of the fund. This new formula achieves consistent and reliable distributions with no new General Fund spending and no new taxes. In 2010, the new formula would have provided K-12 education \$48 million as opposed to the zero distribution the current formula provided. Next year's distributions for K-12 education will be \$62.4 million if the new distribution formula is adopted.

HCR 2056 was passed though the Arizona Senate and House of Representatives and will appear on the ballot this November for voters. If this Constitutional change is passed the new formula will go into effect in 2013 and stay in place until 2021. At the end of the 10-year period the distributions will revert back to the current formula being used today unless further action is taken by a future Treasurer and Legislature.

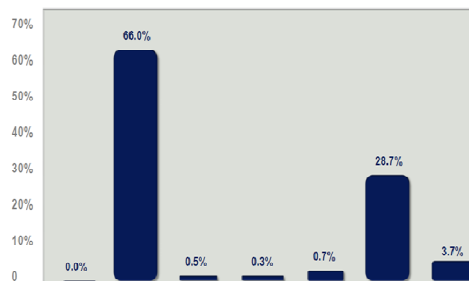
LGIP Pool 5: Short-term fund

AT A GLANCE

- \$1.47 Billion in assets with Net Asset Value at \$1.000 as of 3/31/2012.
- Diversified investments weighted to highly rated Commercial Paper first, Repurchase Agreements second and Agencies/Treasuries third.
- Focus this quarter will be on increasing maturities on products like commercial paper beyond 30 days.
- Continues to maintain the highest rating of AAAF/SI+.
- Weighted Average Maturity is 19 days.

Safety

Continues to receive highest rating from Standard & Poor's: AAAF/SI+

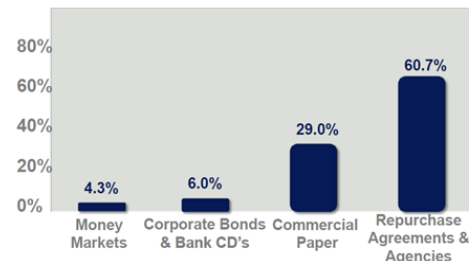


Liquidity

Weighted Average Maturity: 19 days on 3/31/2012

DURATION: 100% from 0-1 yrs

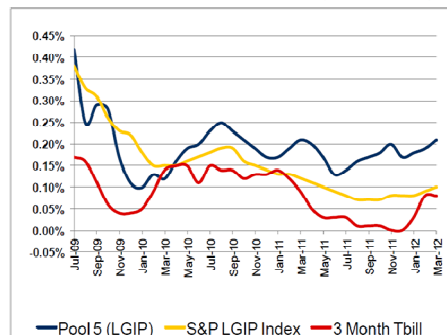
ASSET MIX:



Yield

.18% FYTD

.08% FYTD (S&P LGIP Index)

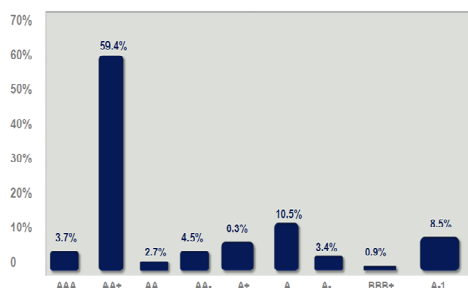


**Pool 5 YTD
Net Yield
has beaten its
benchmark by
10 basis points**

LGIP Pool 500: Medium-term fund

Safety

AA Weighted Average Rating

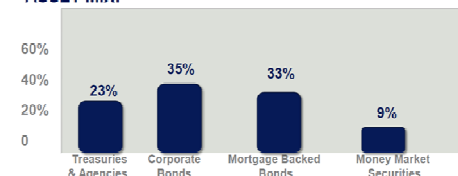


Liquidity

Effective Duration: 1.58 years on 3/31/2012

DURATION:

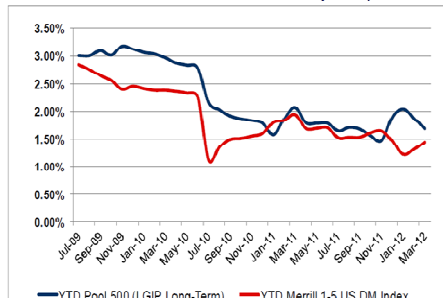
ASSET MIX:



Yield

1.74% YTD

1.47% YTD (Index)



**Pool 500 YTD
has beaten its
benchmark by
27 basis points**

AT A GLANCE

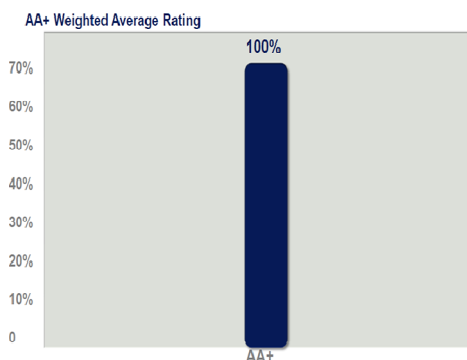
- \$227.8 Million in assets with Floating Net Asset Value at \$1.0395 as of 3/31/2012.
- Diversified fund containing Treasuries, Agencies, Corporate Bonds and Mortgages.
- The effective duration is 1.58 years.
- Keeping the fund short with 61% of the investments maturing under two years.
- Maximum exposure to any credit at 2.5%.
- Weighted Average Rating of all the securities is AA.

Pool 7 LGIP-GOV: Short-term fund

AT A GLANCE

- \$1.6 Billion Assets with Net Asset Value at \$1.00 as of 3/31/2012.
- Invested in highly liquid, low-risk securities that are backed by the full faith and credit of the U.S. Government.
- Repo market eased this most recent quarter. Shifting back to more overnight Repo combined with a constant stream of maturing securities and laddering out Repo purchases along a 3 to 5 week time span.
- Weighted Average Maturity is 22 days.

Safety

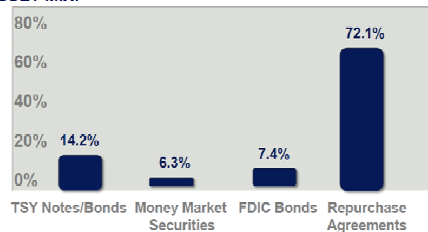


Liquidity

Weighted Average Maturity: 22 days on 3/31/2012

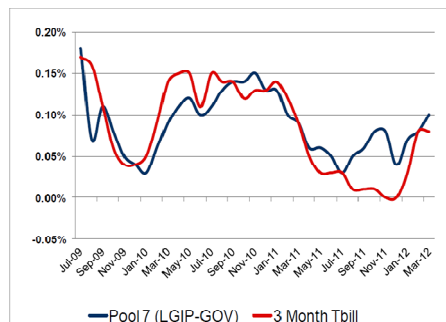
DURATION: 100% from 0-1 yrs

ASSET MIX:



Yield

.07% YTD .03% YTD (90 DAY T BILL)



Pool 7 YTD Net Yield has beaten its benchmark by 4 basis points

Pool 700 LGIP-GOV: Medium-term fund

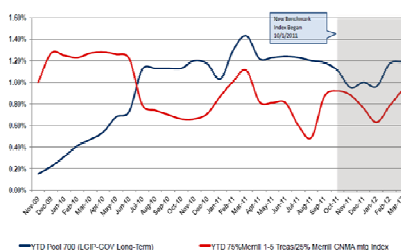
Safety

AA+ Weighted Average Rating



Yield

1.11% YTD 0.87% YTD (Index)



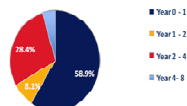
AT A GLANCE

- \$158.9 Million in assets with Floating Net Asset Value at \$1.0111 as of 3/31/2012.
- All securities are backed by the full faith and credit of U.S. Government including Treasuries, FDIC paper and GNMA Mortgages.
- The effective duration is 1.34 years.
- Keeping the fund short with 67% of the investments maturing under two years.
- Weighted Average Rating of all the securities is AA+.

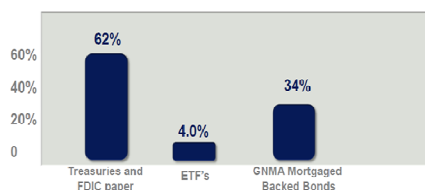
Liquidity

Effective Duration: 1.34 years on 3/31/2012

DURATION:



ASSET MIX:



Pool 700 YTD has beaten its benchmark by 24 basis points

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View AZ's Daily Cash Balance at www.AZCheckbook.com

Harry A. Papp Joins the BOI

Treasurer Ducey appointed Harry A. Papp, Chartered Financial Analyst (CFA), to the Arizona Board of Investment (BOI) on February 28, 2012.

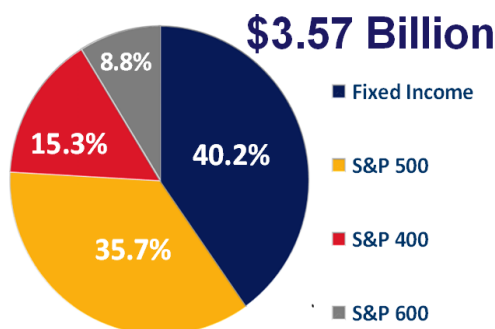
Mr. Papp is the Managing Partner for L. Roy Papp & Associates, LLC, and also serves on the Board of Directors of Blue Cross and Blue Shield of Arizona, and the Board of Directors and Board of Trustees of the Arizona State University Foundation. He earned a Master of Business Administration in Finance and Accounting and a Master of Science in Geochemistry from the University of Chicago, and a Bachelor of Arts degree from Brown University.



Arizona's BOI serves as trustees of the \$3.5 billion Permanent Land Endowment Trust Fund, reviews the investment of state monies on a monthly basis and oversees the Treasurer's Office Investment Policy. Other members of the BOI include State Treasurer Doug Ducey, who serves as the Chairman of the Board; Scott Smith, Director of the Department of Administration; Lauren Kingry, Superintendent of Financial Institutions and Hon. Beth Ford, Pima County Treasurer.

Land Endowment Asset Allocation

(as of March 31, 2012)



NCFE & Lehman Update

In March, a Motion to Dismiss by Credit Suisse in the NCFE case was ruled on that was largely in our favor. The legal team from Gibbs & Bruns is prepared to have the case tried in Arizona within a year.

In April, the Treasurer's Office received the first distribution of **\$2.37 Million** (6% of the bonds) from the Lehman Brothers bankruptcy estate.

State Cash Flow

**FY 2012 Q3 Average
Monthly Cash Balance:**

+75% YOY

**January = \$1.511 B
February = \$1.5 B
March = \$1.373 B**

FY 2012 YTD Earnings +\$56.6 Million YOY

